Manager's Commentary

Justin Jacobsen, CFA

Highlights

- The broad-based rally provided an opportunity to sell liquid high-yield positions at prices that we viewed as fully valued.
- There were several positive developments within our Event Driven book including Black Knight Inc. (NYSE: BKI), Arconic Corp. (NYSE: ARNC), and PDC Energy Inc. (NASDAQ: PDCE)
- We are watching commercial real estate where defaults mount and cap rates have not adjusted to the current interest rate regime.

The Pender Alternative Absolute Return Fund finished July with a return of 0.6%, bringing year-to-date returns to 4.0%[1].

Markets continued to grind higher in July in what is often a seasonally strong time of year. In the high yield market, there has been a negative return in the other 11 months of the year at least once in the past two years, but there has not been a negative July since 2015. High yield spreads compressed by 26bp in the month to finish at 379bp, more than 100bp tighter on the year and well below the 10-year average which is in the mid-400s.

Portfolio Update

The broad-based rally in July provided an opportunity for the Fund to sell liquid high yield positions at prices that we viewed as fully valued, resulting in a defensive posture at the end of the month. For much of the past several weeks it has appeared to us that the market has jumped over positive macro developments, while relatively negative news was often ignored. While these dynamics can persist for some time, eventually a more sober view of risks and opportunities will be reflected in asset prices.

There were several positive developments within our Event Driven book in July. Our position in Black Knight Inc. (NYSE: BKI) equity popped following positive developments that caused the market to dramatically re-price the probability of their merger with Intercontinental Exchange Inc. (NYSE: ICE) closing. The gain in BKI was only partially offset by a modest loss in ICE special mandatory redemption bonds which pay out at a premium to market if the deal were to break. We had traded in and out of ICE 2062 bonds many times over the past several months, including in July but we had sold our position into strength following the large rally in long duration bonds in response to the US CPI data in mid-July, leaving us with a position in ICE bonds which mature in 2027. In response to the market repricing, we sold out of our BKI position and reduced our holdings of ICE 2027 bonds.

Two other M&A related positions performed well in July. Our position in Arconic Corp. (NYSE: ARNC) bonds rallied on news that they would be called in connection with Apollo's LBO of the company, resulting in an outcome that was about two points better than the $101 Change of Control put that the market had assumed was the likeliest result from the transaction. We were able to scale this position meaningfully at an attractive discount to the call price. Late in July we received a call notice which suggests that this position will be converted to cash in August. Finally, our position in PDC Energy Inc. (NASDAQ: PDCE) 5.75% 2026 bonds rallied on news that the merger with Chevron Corporation (NYSE: CVX) would close more quickly than the market had expected. We elected to sell most of our holdings into strength with the view that the ultimate outcome is uncertain. This proved to be accurate as in early August, Chevron announced a consent solicitation whereby the bondholders would receive only 0.1

[1] *All Pender performance data points are for Class F of the Fund. Other classes are available. Fees and performance may differ in those other classes.*

point of the 1.4 point call premium in exchange for relieving Chevron of their obligations to report separate PDCE financials. Our investment thesis was based on this reporting requirement being enough of a nuisance for Chevron to call the bonds. The call premium is roughly $10 million for a merger valued at $7.6 billion when it was announced, with a market capitalization of around $300 billion, Chevron has plenty of financial resources to call the bonds and move on. We do not expect the consent solicitation to pass as currently proposed.

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With cash levels increasing, the Fund purchased 6-month T-bills in both Canada and the US in July. With yields above 5% we view cash as a legitimate asset class while waiting for better risk premiums to emerge in the coming months.

Portfolio Metrics

The Fund finished July with long positions of 133.9%. 28.6% of these positions are in our Current Income strategy, 89.1% in Relative Value and 16.2% in Event Driven positions. The Fund had a -69.8% short exposure that included -14.2% in government bonds, -37.9% in credit and -17.7% in equities. The Option Adjusted Duration was 1.11 years.

Excluding positions that trade at spreads of more than 500bp and positions that trade to call or maturity dates that are 2025 and earlier, Option Adjusted Duration declined to 0.74 years. The duration figure include an Event Driven position where we believe duration does not accurately reflect the option value embedded in the security.

The Fund's current yield was 4.68% while yield to maturity was 6.16%

Market Outlook

The strong market performance so far in 2023 has been a welcome relief to many market participants. However, the reality is that the capital gains in equities and the spread compression in credit are approaching levels where we believe it could be challenging to rally further. In the first seven months of the year high yield spreads narrowed by over 100bp. An additional 100bp of tightening from here would take spreads to the lowest level since 2007 which we believe is highly unlikely. In our view, there is a negative skew to asset prices over the near term and we are positioned accordingly.

At the start of the year, we were expected to be entering a central bank easing cycle by now, Fed Futures markets had priced in a portion of a rate cut for the July FOMC meeting. The reality is that rates are likely to be higher for longer, as evidenced by continued rate hikes from central banks in July and an easing of yield curve control by the Bank of Japan. Commodity prices have perked up in recent weeks and could be a leading indicator of goods inflation. We see widespread evidence that market participants are expecting and positioned for lower rates over the near term, while we believe that the risks are balanced between higher and lower rates. One area that we are watching closely is commercial real estate, where defaults continue to mount and cap rates have yet to adjust to what we view as an appropriate risk premium for the current interest rate regime.

The last several months have been a tricky environment for the Fund, as upward momentum has looked unstoppable at times. We continue to believe that a disciplined and patient approach to risk management will be rewarded in the months ahead.

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Bond prices are reflected as a percentage of par in their local currency.
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